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PP RUEHCHI RUEHDT RUEHHM  
DE RUEHJA #0688/01 0680844  
ZNR UUUUU ZZH  
P 090844Z MAR 07  
FM AMEMBASSY JAKARTA  
TO RUEHC/SECSTATE WASHDC PRIORITY 3733  
INFO RUEATRS/DEPT OF TREASURY WASHINGTON DC  
RUCPDO/DEPT OF COMMERCE WASHDC  
RUEHZA/ASSOCIATION OF SOUTHEAST ASIAN NATIONS  
RUEHKO/AMEMBASSY TOKYO 0339  
RUEHBJ/AMEMBASSY BEIJING 3925  
RUEHBY/AMEMBASSY CANBERRA 0509  
RUEHUL/AMEMBASSY SEOUL 3951  
ZEN/AMCONSUL SURABAYA

UNCLAS SECTION 01 OF 03 JAKARTA 000688

SIPDIS

FROM AMCONSUL SURABAYA 0028

DEPT FOR EAP/MTS, EB/IDF/ODF  
COMMERCE FOR 4430-GOLIKE  
TREASURY FOR IA-ANDY BAUKOL

SENSITIVE  
SIPDIS

E.O. 12958: N/A

TAGS: [ECON](#) [EINV](#) [EAID](#) [PGOV](#) [KCOR](#) [ID](#)

SUBJECT: Yogyakarta Earthquake: Economic Recovery Rapid,  
Sustainability Questioned

Refs: A: 06 Jakarta 13583  
B: 06 Jakarta 6779 notal

¶1. (SBU) SUMMARY. The May 2006 earthquake that shook Yogyakarta and surrounding areas caused \$2-3 billion of damage and destroyed over 33,000 businesses, mostly small and medium enterprises (SMEs). ConGen Surabaya visited the affected areas on February 12-13, 2007 and met regional economic and business contacts to assess the recovery to date. Economic data shows the local economy suffered immediately after the quake and began a rapid recovery once government reconstruction funds began arriving. Ongoing regional reconstruction efforts are creating a tight labor market and rising wages. Our business contacts say labor market conditions and limited availability of working capital are delaying the reopening of SMEs and resumption of normal business operations. Economic contacts suggest capacity building for SMEs, micro-credit lending and basic management consulting services as means to assist small business recovery. Even large businesses are struggling to recover employees and maintain customer orders in the aftermath of the earthquake. Residents complain that local governments are misappropriating GOI reconstruction funds, which are in any case insufficient to replace damaged homes. END SUMMARY.

#### Earthquake and Response Summary

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¶2. A powerful earthquake shook the Indonesian province of Yogyakarta and surrounding areas on the morning of May 27, 2006. The earthquake caused \$2-3 billion in damages in several regencies of the Yogyakarta and Central Java provinces. Final reports confirmed more than 5,700 people dead, 57,000 people injured and 237,400 houses destroyed or damaged beyond repair (Ref B). The U.S. military provided a fully staffed, temporary emergency medical hospital, instrumental in preventing additional loss of life. USAID/OFDA made available \$6 million of immediate relief and recovery assistance, mainly funding construction of over 10,000 temporary housing units, safe water and sanitation and shelter-related training. (Ref A).

¶3. The GOI announced its plan to provide \$1.2 billion for earthquake reconstruction, \$131.4 million earmarked for housing during 2006, with an additional \$240 million of housing funds made available in ¶2007. These funds are targeted primarily for permanent housing replacement. Other GOI funds are targeted for school, hospital and

infrastructure repair and replacement. According to local officials the housing replacement funds began arriving in October 2006, starting a local construction boom. Our contacts are not aware of any GOI or donor programs or funds directed for the recovery of businesses after the earthquake.

#### GOI Reconstruction Funds Push Local Economy

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14. (SBU) Immediately after the earthquake, with over 33,000 businesses destroyed and many families in mourning, the regional economy slowed dramatically, according to the Bagus Santoso, Professor of Development Economics at Gajah Mada University in Yogyakarta. His analysis shows the regional economy contracted at more than a 15% annual rate for the four months after the quake until the reconstruction funds began arriving. Fourth quarter 2006 growth recovered strongly, spurred by the large cash infusion. The Yogyakarta regional economy ended up growing 3.0% in 2006, compared to 4.6% growth in 2005. Santoso projects 2007 Yogyakarta regional growth to exceed 5.0%. Santoso remarked that, unlike Aceh, prices of construction materials had not jumped up significantly, even though construction of tens of thousands of new homes has begun. He noted that building materials stockpiles were transported from other parts of Central Java and many of the surviving small businesses dropped their traditional product lines to start manufacturing of local construction materials.

#### Labor Market Tightening

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15. (SBU) GOI efforts to rebuild the 1,600 public schools and dozens of hospitals and medical clinics destroyed have increased local labor demand. Wages for day construction laborers have more than

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doubled, increasing local incomes and attracting workers from outside the region. High wage rates are attracting skilled workers trained in traditional local industries to work as unskilled construction laborers. The tight labor market is limiting the ability of many small and medium enterprises damaged by the earthquake to resume normal operations due to high labor costs and lack of skilled labor availability.

#### Local SMEs Lack Capital, Collateral to Reopen

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16. (SBU) In addition to rising labor costs, a significant impediment to SMEs resuming operation is a lack of capital. Economists and business association contacts tell us that the damaged businesses have no way to raise capital to restart operations because the collateral value of their property was greatly reduced by the quake.

Bank Indonesia (BI) has implemented rules forestalling foreclosure on non-performing business loans. However, the business owner's real estate still secures their existing loans preventing them from borrowing fresh capital to replace lost materials and equipment and repair damaged structures. The traditional practice of family and friends loaning funds in emergencies is generally no longer a useful source as many families must direct remaining savings to home repairs or medical fees for earthquake-related injuries.

17. (SBU) Our Yogyakarta business and economic contacts expressed concern that the regional economy is currently strong but unsustainable. Once the reconstruction funds are depleted, they fear the tens of thousands of businesses that have been dormant during reconstruction will face great hardship recovering customer bases and successfully reopening. There is little confidence that the banking system has sufficient micro-lending capacity to respond to the looming need, according to Dr. Mudrajat Kuncoro, economics professor at Gajah Mada University and leader of the SME Recovery Center. Kuncoro added that there are no more than 50 lenders in all of Yogyakarta trained to make the kinds of small business loans needed. He suggested any type of SME and micro-lending capacity building programs available would have a tremendous impact assisting local businesses to recover.

18. (SBU) Edy Suandi Hamid, Rector of the Indonesian Islamic

University in Yogyakarta and Head of the local chapter of the Indonesian Economist Association (ISEI), told us that the ISEI is developing a management consulting program to assist SMEs closed by the earthquake to reopen. They have a group of volunteers, primarily local academics and accountants, willing to give their time and expertise to business owners. Hamid described goals similar to those of the USAID/SENADA Indonesia Competitiveness Program which operates in other cities in Indonesia. ISEI has not developed any type of systematic approach to providing consulting services. Hamid thought that bringing the Indonesia Competitiveness Program to Yogyakarta, even if to just train their volunteers, would provide great benefit to businesses in need of assistance.

#### A Recovery Story

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¶9. (SBU) PT. Rumindo Pratama (Rumindo) is an example of a large scale business's struggles in the aftermath of the earthquake. Rumindo is one of the largest employers in the most heavily affected area of Yogyakarta, manufacturing more than 700,000 handmade women's handbags per year for export. Their products are featured in many major U.S. retail outlets such as J.C. Penny and Macy's. Prior to the earthquake, Rumindo employed 5,400 villagers in rural areas around Yogyakarta handcrafting woven bags and 600 at their factory finishing and shipping the bags. The Rumindo factory was completely destroyed by the quake. Within a week, they identified an abandoned furniture factory still standing. As their employees returned to work, they began salvaging equipment and materials to reassemble their production lines and get back in business. By day, senior management traveled to all of their village-based employees consoling them and encouraging them to resume working. By night, senior managers reassured nervous customers in the U.S. and Europe that Rumindo would complete their orders in time for the following spring season. Despite their gargantuan efforts, Rumindo lost one third of their workforce to death, injury, depression and higher paying construction work and one half of their orders to competitors

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in China and Thailand willing to take advantage of their misfortune. Rumindo management feels fortunate they survived the worst and remain in business.

#### Residents Struggle to Rebuild

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¶10. Interviews with local residents rebuilding their homes revealed several areas of dissatisfaction with the GOI recovery program. The most vocal complaint was that the Rp. 15 million (\$1,650) provided by the government per house was only sufficient to build a foundation, walls and a roof. There are no funds for windows, doors, electricity, lights, fans, plumbing or floors provided. What little savings the villagers had was already spent on funeral expenses, medical bills and living expenses for their unemployed family and friends for the past nine months. Their other frequent complaint was that corruption by facilitators and local officials was costing 10-20% of their government awards. Paying small "gratuities" to local officials for simple government services is a normal part life in the village. However, residents became animated at the large sums being demanded to facilitate local building department approvals and "guarantees" that their new homes would pass earthquake safety standards without regard to the construction techniques or materials used. The GOI reconstruction program requires homes pass minimum earthquake safety standards in order to receive the next stage of funds.

#### An Unmet Need

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¶11. (SBU) The GOI and the donor community have focused on the most immediate needs for medical care and shelter replacement. Yogyakarta residents expressed gratitude for the assistance they have received. A spirit of cooperation was evident in villages as community members worked on rebuilding each others homes. Our contacts and local residents spoke of the importance of "Gotong Royang", or community connectedness, and their hope that the "social capital" at the village level can be translated into financial

capital to restart lost businesses. The economic recovery is heading to its next stage where residents are ready to focus on regaining lost livelihoods. An opportunity may exist to leverage existing USG sponsored business assistance programs to address an unmet long-term recovery need of the Yogyakarta region. Activities along this line are likely to happen in the near future as SENADA begins redirecting its regional focus and expanding business management assistance in the greater area of Central Java, including Yogyakarta.

PIERANGELO/HEFFERN